Exhibit B

naked capitalism

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Wednesday, June 18, 2008

Bloomberg: Lehman Sold $5 Billion of Assets to Investee Hedge Fund

A Bloomberg article shed some light on a story passed to us, namely that some of the Lehman asset sales had been achieved via transfers to 2 funds in which Lehman retained an economic interest. While we indicated that our information fell in the category of a rumor, since it came from a single source and the information was not of the sort that could be readily corroborated, the Bloomberg article confirms many of the elements he presented.

Lehman did indeed sell $5 billion of assets to a fund in which the investment bank has an economic interest, R3 Capital Partners, and its founder was indeed the former head of Lehman's principal investing group. The disparity with our report was that the amount alleged to have been sold was much greater, $55 billion versus the $5 billion in the Bloomberg story. However, this $5 billion is material relative to the $70 billion of net asset sales Lehman reported for the last quarter and begs the question of whether it should have been disclosed in the supplemental information provided at the same time as the earnings press release. We hope that the 10-Q filing, which will contain the balance sheet and footnores, will be more forthcoming.

The second fund mentioned in the earlier post, One William Street, is also run by a former Lehman staffer, as our source had indicated. However, the Bloomberg piece is silent on whether Lehman in an investor in this fund or not. The Bloomberg story says the assets sold by Lehman to that fund were a mere $5 million.

Note that while this information is very helpful, it still leaves unanswered the question of how Lehman achieved these sales, particularly since they were spread across a wide range of instrument types and credit qualities. The markets are still difficult; it is normally much easier to sell better rated paper at decent prices than lesser rated instruments. Even if Lehman's marks were reasonable assuming small transaction sizes, larger sales generally have a negative market impact and thus could lead to losses upon

disposition (and have the unfortunate side effect of forcing Lehman to mark down remaining positions similar in type). Other banks have financed sales of leveraged loans and some Alt-A portfolios. It isn't out of the question that some of the other assets sold by Lehman were financed or placed with entities in which the firm has an economic interest.

From Bloomberg:

> Lehman Brothers Holdings Inc. invested in former trader Rick Rieder's new hedge fund and sold it about $5 billion of assets, positioning the investment bank to profit from the stakes while shrinking its own balance sheet.
>
> Lehman, the fourth-biggest U.S. securities firm, is a minority investor in the fund, called R3 Capital Partners,…
>
> "These are assets we feel very comfortable with," Rieder, 46, said in an interview today. "They have terrific potential for great returns. Just like other shareholders, Lehman will benefit from the returns we'll make going forward."
>
> The 21-year Lehman veteran most recently ran the global principal strategies group, investing in credit arbitrage, aviation finance and private equity, and left the firm last month to start R3 in New York. Lehman, which reported a $2.8 billion second-quarter loss earlier this week, sold $147 billion of assets in the three months ended May 30 as it hunkered down to weather the credit crisis.
>
> Rieder said 75 percent of the assets his fund bought from Lehman were corporate bonds and loans. There were also some distressed debt and aviation stakes in the mix, two other areas he focused on while at Lehman. The fund will continue to acquire similar holdings in the marketplace, Rieder said….
>
> Among the assets sold during the past quarter were $26 billion of mortgage bonds and leveraged loans, which have plummeted in value during a credit-market contraction that has saddled banks and brokerages worldwide with about $396 billion of losses.
>
> R3 bought about $100 million of Lehman's so-called Level 3 assets, which are the hardest to value because market prices are scarce, according to people familiar with the matter. Most of the firm's mortgage-related holdings are categorized as Level 3, along with other distressed debt.
>
> Lehman sold $3.5 billion of Level 3 assets during the quarter, the firm's finance chief, Ian Lowitt, told analysts in a June 16 conference call.
>
> David Sherr, another former Lehman executive who set up his own hedge fund, bought less than $5 million of assets from Lehman, according to people with knowledge of the transaction. His New York-based fund, One William Street Capital Management, has about $500 million under management.
>
> Sherr, who headed Lehman's securitization division until he left the firm in December, didn't reply to a phone call seeking comment.

More on this topic (What's this?)

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Email This Post Posted by Yves Smith at 11:01 pm

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8 Comments:

- *etc* says:

June 18, 2008 at 9:07 pm

"It isn't out of the question that some of the other assets sold by Lehman were financed or placed with entities in which the firm has an economic interest."

Exactly, the question is whether there was LEH sold at prices above intrinsic value and bears the risk of the inflated sale price by having provided nonrecourse financing or bearing risk of loss through a guarantee, CDS, or otherwise.

- *Anonymous* says:

June 18, 2008 at 9:49 pm

Yves, have you heard whether the other $65 billion(70- $5 that went into Rieder's fund)of net assets were sold for cash or other non-liquid asset? Just wondering if LEH was able to arrange exchanges with counterparties where they possibly received illiquid high risk assets in return for the high risk assets they gave up. It could allow them to still treat the transactions as sales and also allow them establish valuation benchmarks(subject to manipulation) for other assets they still hold. Could be a takeoff on the artificial "round-trip" revenue transactions employed by Enron and others in earlier years. Just wondering…

- *stuart* says:

June 18, 2008 at 10:01 pm

as a firm believer in the cockroach theory, the $5B could've been just one sale transaction with many others yet to be reported on, that in aggregate is close to $55B. Given that so many other details are so similar, I somewhat expect the totals to be similar in the end story as well.

- *Anonymous* says:

June 18, 2008 at 10:05 pm

Did they sell, get cash and independently pay down debt(without quid-pro quo). Or did they exchange gross asset + piece of debt in exchange for a similarly risky "net asset". (Which could also give the appearance of de-leverging)

- *tomd* says:

June 18, 2008 at 10:20 pm

If I were a "buyer" with no personal liability, I would be liberal with the "price" I paid if LEH were liberal with the financing of the deal.

A huge clue was in that arrogant posting by what appeared to be a LEH BSD last week. His/her "explanation" consisted of capitalizing the word SOLD rather than providing a single detail. In other words, "tiger", the assets were SOLD because I said so. Now go away, stop bothering me.

That alone tells me the deals are full of BS. Totally consistent with LEh's focus on managing the PR rather than dealing with their problems.

TomD

- *eh* says:

June 19, 2008 at 3:18 am

Totally consistent with LEh's focus on managing the PR rather than dealing with their problems.

If the Fed can do it, why not LEH? Still no word that I have heard on what the end game for those assets traded for treasuries will be, other than some recent emphasis that the 'alphabet soup' would go cold sometime. Does anyone really believe that paper will fetch a better mark later this year? The Fed has given these creeps a modus operandi.

- *Anonymous* says:

June 19, 2008 at 4:09 am

Wow, Yves, fantastic! Not only does Charlie G and his Murdoch crew monitor your blog, this shows that many other large media types do too. Who started the basis for this article? Don't you find it eerily odd that a bbrg article pops up the day after your article with the counterpoint spin?

- *Richard Kline* says:

June 19, 2008 at 5:40 am

So stuart, that does seem an astute read, yes. The overall similarity of the article to the earlier source position is quite suggestive, even while the timing and size of the numbers suggest spin as anon of 5:09 says. It doesn't sound likely that LEH would have moved $55-70B in a bundle, but rather in packets. And recall that the LEH official numbers on how much they have 'sold' don't fully jibe with their remaining stated obligations, suggesting that many of the so-designated 'sold' assets may be _on-going

transactions_, i.e. earmarked for sale rather than actually transferred. More and more this sounds like the Lehman's statements of recent weeks are explictly to manage reporting and market response so they could 'beat the number' rather than to give a clear picture of their PRESENT FULL EXPOSURE. . . . If so, isn't that illegal as materially misleading information even if LEH manages to actually complete any such 'sales in progress'? . . . Do the laws have any force if the Center Banker cannot fold??

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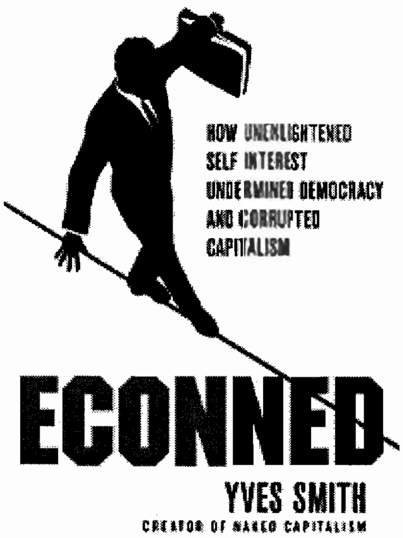

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